

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SPARTACUS OF THRAKI, INC.	:	DETERMINATION
		DTA NO. 819589
for Revision of a Determination or for Refund of Sales and	:	
Use Taxes under Articles 28 and 29 of the Tax Law for	:	
the Period March 1, 2000 through May 31, 2002.	:	

Petitioner, Spartacus of Thraki, Inc., c/o Kyriako Skevas, 25-56 31st Street, Astoria, New York 11102, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 2, 2000 through May 31, 2002.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 22, 2004 at 10:30 A.M., with all briefs to be submitted by August 20, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Edmund J. Mendrala, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Michael P. McKinley, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly estimated petitioner's taxable restaurant sales based upon the use of an observation test conducted during the period at issue but originally used for an earlier audit.

II. Whether penalties were properly imposed.

FINDINGS OF FACT

1. Petitioner, Spartacus of Thraki, Inc., operated a Greek restaurant known as Spartacus Restaurant in Huntington, Long Island, which had been established as a family-run restaurant in 1978. With its 12 booths and 5 tables, the restaurant had a seating capacity of 68 and also sold take-out food. In happier days, Kyriakos Kalfas¹ and his wife, Rali, with their three children, all worked in the restaurant then known as Aetos Restaurant. However, after a contentious divorce, Kyriakos Kalfas obtained sole ownership of the restaurant as part of a marital settlement, and during the period at issue beginning in May of 2000, he operated the renamed Spartacus Restaurant without any assistance from his wife and children. Although the restaurant kept the same menu, consisting of a variety of Greek dishes as well as vegetarian specialties, and the same prices, the business would deteriorate and eventually close in early June of 2002.

2. In the late fall of 2001, the Division of Taxation (“Division”) requested that the Office of the Comptroller of Suffolk County conduct “a sales tax sweep” of Suffolk County restaurants that reported gross sales of less than \$35,000 per quarter. Of the 48 restaurants caught up in the sweep, which included mini-observations of the respective business premises by the county’s investigators, Suffolk County determined, pursuant to a report dated December 12, 2001, that all 48 restaurants, including petitioner, were underreporting taxable sales and recommended that the Division perform sales tax audits of each of the 48 restaurants. The mini-observation of petitioner, conducted on May 1, 2001 by a Suffolk County investigator, noted that petitioner was “more of a sit down restaurant on a very busy section of New York Avenue” in Huntington presumably raising questions about the minimal taxable sales reported.

¹ Kyriakos Kalfas does not contest his status as a responsible person for the corporation, Spartacus of Thraki, Inc. A separate assessment notice dated September 26, 2002 issued to Mr. Kalfas as a responsible person is deemed protested pursuant to Tax Law § 1138(a)(3)(B).

3. Although an audit of petitioner had been recommended by Suffolk County in December of 2001, it was not until June 28, 2002, that an audit of petitioner was assigned by the Division's Suffolk County audit office. This assignment was prompted by the audit office's receipt on June 26, 2002 of an e-mail memo from the Division's bulk sale unit in Albany stating that a bulk sale notice had been received identifying petitioner as the seller. The audit office was advised that for the bulk sale unit to assess the bulk sale purchaser of petitioner's business for any outstanding sales tax liability of petitioner, an audit of petitioner must be posted to its case tracking system by August 21, 2002. Consequently, a sales tax audit of petitioner was given priority.

4. By a letter dated July 11, 2002, the Division's auditor advised petitioner that its tax records for sales tax for the period at issue were going to be audited commencing on July 22, 2002 at petitioner's office. Petitioner was further advised that it must make available for audit all books and records pertaining to its sales and use tax liability, and a "Records Requested List" was enclosed with the letter. This list of records to be produced by petitioner included the following:

- Sales tax returns, worksheets and canceled checks for entire audit period
- Federal income tax returns
- NYS corporation tax returns
- General ledger
- General journal and closing entries
- Sales invoices
- All exemption documents supporting non-taxable sales
- Chart of accounts
- Fixed asset purchase/sales invoices
- Expense purchase invoices
- Merchandise purchase invoices
- Bank statements, canceled checks and deposit slips for all accounts
- Cash receipts journal and sales journal
- Cash disbursement journal and purchase journal
- The corporate book
- Power of attorney

- Financial statements
- Depreciation schedules
- Copies of leases
- Guest checks and cash register tapes
- State Liquor Authority license

5. On July 22, 2002, the auditor went to the business premises for the scheduled appointment and discovered that the restaurant was boarded up with a sign in the window that said, "Il Pannino Restaurant coming in August." She then mailed a follow-up letter dated July 24, 2002 to Kyriakos Kalfas. She enclosed a copy of her earlier audit appointment letter dated July 11, 2002 and requested that Mr. Kalfas call her by August 5, 2002 to schedule the audit or she would use information available on file to determine if there was a sales tax liability. With no response from Mr. Kalfas to this follow-up letter, she mailed a letter dated August 6, 2002 with an enclosed Statement of Proposed Audit Change also dated August 6, 2002 and requested a response by August 19, 2002 indicating whether Mr. Kalfas agreed or disagreed. This statement asserted sales tax due of \$69,783.38 plus interest and penalty. On August 12, 2002, the auditor received a telephone call from Kyriacos Skevas, who identified himself as petitioner's representative and stated that Mr. Kalfas was away on vacation until September.

6. The computation of additional tax due asserted on the Statement of Proposed Audit Change was based upon the results of an observation test conducted at the restaurant on May 5, 2000 for purposes of a prior audit of the business for the earlier period of March 1, 1997 through November 30, 1999, when it was known as Aetos Restaurant and operated by Mr. Kalfas and his former wife with the assistance of their children, as noted in Finding of Fact "1". Coincidentally, May 5, 2000 was the second day that Mr. Kalfas had operated the restaurant as Spartacus Restaurant.

7. The observation test on May 5, 2000 was conducted in a thorough and professional fashion by two investigators of the Division. Since the restaurant served lunch and dinner, the first investigator arrived at the premises at 11:00 A.M. and ascertained that the cash register was zeroed out at the start of the business day. The second investigator relieved the first investigator at 5:00 P.M. and stayed until the restaurant closed at 11:00 P.M. The investigators each sat at a table in the restaurant and recorded the day's sales based on information on guest checks and sales rung up on the cash register. They recorded time of day, guest check number, amount of gross sale and whether the order was dine-in or take-out. They recorded gross receipts of \$1,221.91 (\$914.49 dine-in and \$307.42 take-out) based on the information on the guest checks. The cash register tape for the day showed gross receipts of \$1,189.16, presumably a sale of \$32.75 had not been rung up on the register to explain the minor difference. The investigators also observed that the restaurant had six employees in the course of the day including Mr. Kalfas who worked in the kitchen as the cook.

8. To calculate sales tax due for the period at issue, the auditor divided the gross receipts for the observation day of \$1,221.91 by 1.0825% (thereby backing out sales tax collected on such receipts at the Suffolk County rate of 8.25%) to arrive at taxable sales of \$1,128.79. She then multiplied such taxable sales per observation of \$1,128.79 by 90 days to determine taxable sales per quarter. The auditor then multiplied this result by nine, since the audit period running from March 1, 2000 through May 31, 2002 equates to nine sales tax quarters, to arrive at taxable sales for the period at issue of \$914,316.03. Subtracting taxable sales reported by petitioner for

the nine quarters of only \$77,718.00,² the auditor calculated additional taxable sales of \$836,598.03 and additional sales tax due of \$69,783.38.

9. The Division then issued a Notice of Determination dated September 3, 2002 against petitioner, asserting additional sales and use taxes due of \$69,783.38 for the period March 1, 2000 to May 31, 2002, plus interest and penalties. Penalties were imposed for underpayment of tax, including the omnibus penalty, since additional tax due was more than 25 percent of the audited tax due.

10. As noted in Finding of Fact “1”, the restaurant run by Mr. Kalfas as Spartacus Restaurant would deteriorate and eventually close in early June of 2002. But even before Mr. Kalfas assumed sole responsibility for the restaurant’s operation, the business was in decline as a result of contentious relations between Mr. Kalfas and his ex-wife, Rali Kalfas. She was fluent in English and had developed the restaurant’s clientele, while Mr. Kalfas remained in the kitchen as the chef. With the failure of their marriage, Mrs. Kalfas bad-mouthed the restaurant to

² Petitioner reported taxable sales of \$77,718.00 over the nine sales tax quarters as follows:

Sales tax quarter ended	Taxable sales reported
May 31, 2000	\$ 9,638.00
August 31, 2000	12,810.00
November 30, 2000	11,183.00
February 28, 2001	7,892.00
May 31, 2001	7,804.00
August 31, 2001	6,992.00
November 30, 2001	7,178.00
February 28, 2002	7,390.00
May 31, 2002	6,831.00
Total	\$ 77,718.00

customers. At the time Mr. Kalfas took over sole responsibility for the operation, he was in his early 70s and sought almost immediately to sell the business. For the last two sales tax quarters at issue, Mr. Kalfas was operating the restaurant with no assistance from any employees and beginning in November of 2000, he would operate the restaurant only five or six days per week. A part-time waitress, Phannie Delnuevo, worked for him at different times during the audit period along with an unidentified “old man who came in sometimes to help out” (tr., p. 136).

11. The Division has proposed findings of fact in a narrative format, relevant portions of which have been incorporated herein. Although State Administrative Procedure Act § 307(1) requires a ruling “upon *each* proposed finding of fact [emphasis added],” since the Division has not separately numbered each of its proposed findings of fact, they have not been so ruled upon.

SUMMARY OF THE PARTIES’ POSITIONS

12. The Division asserts that the audit method to determine sales tax due, which utilized a one-day observation test, was reasonable when “a taxpayer does not provide books and records to support its reported sales” and based on a long line of case law may be “extrapolated over a multiple-year period” (Division’s brief, p. 10). In particular, the Division points to the decision of the Tax Appeals Tribunal in ***Matter of Burbacki*** (February 9, 1995) wherein the Tribunal approved the Division’s reuse of an observation test conducted in 1986 for an earlier assessment as the basis for projecting taxable sales for a later assessment in 1991. Further, the Division contends that the “absence of supporting records bears heavily against a taxpayer whose inexactitude is of his own making” (Division’s brief, p. 12). The observation test of May 5, 2000 accurately measured the taxable sales of Spartacus Restaurant on such day, and according to the Division, petitioner has failed to offer any clear proof to undermine the Division’s calculation. Finally, the Division maintains that penalties were properly imposed since

petitioner failed to pay sales tax when due, and it has failed to prove that its failure was due to reasonable cause and not willful neglect.

13. Petitioner responds that the Division's conduct was "outrageous" because it used an observation test "to determine the liability of another taxpayer," i.e., Spartacus Restaurant, not the taxpayer observed, Aetos Restaurant (Petitioner's brief, p. 3). The Division failed to consider the fact that petitioner's business deteriorated to the point where it closed its doors. According to petitioner, the "testimony of Mr. Kalfas outlines the decline of the business operations, his personal subsidy of the operations using his Social Security checks and the only motivation of trying to keep the doors open was to sell the restaurant" (Petitioner's brief, p. 9).

CONCLUSIONS OF LAW

A. Every person required to collect sales tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a][1]). As noted in the findings of fact, petitioner failed to produce any records sufficient to verify its restaurant sales during the audit process. Consequently, the Division's right to resort to an estimate of its sales, as long as it selected an audit method reasonably calculated to reflect the sales and use taxes due, remains unassailable (*see, Matter of Rincon*, Tax Appeals Tribunal, October 9, 2003). Petitioner correctly points out that the Division was under a time constraint in issuing the notice of determination as a result of petitioner's bulk sale of its restaurant business. In order to preserve its right to collect any unpaid sales tax owed by petitioner from the bulk sale purchaser pursuant to Tax Law § 1141(c), the Division was required, within 90 days of receipt of the notice of the bulk sale, to give notice to the purchaser and to petitioner of "the total amount of any tax or taxes which the state claims to be due from the seller" (*cf., Matter of North Shore Cadillac-Oldsmobile*, Tax Appeals Tribunal, April 3,

2002, *confirmed* __ AD2d __, __ NYS2d __ [3d Dept 2004]). Nonetheless, this time pressure on the Division does not alter the pivotal fact that petitioner was given a sufficient amount of time by the Division during the summer of 2002 to provide records for the auditor's review and failed to do so. Consequently, it may be concluded that the Division properly resorted to an estimate of petitioner's taxable sales (*cf.*, *Matter of Sarantopoulos*, Tax Appeals Tribunal, February 28, 1991, *confirmed* 186 AD2d 878, 589 NYS2d 102).

B. The Division's use of a one-day observation test conducted during a prior audit provided an adequate basis to estimate petitioner's taxable sales for the audit period under review (*cf.*, *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004 [wherein the Tribunal affirmed the administrative law judge's decision in *Matter of Marte* (November 13, 2003) in which he noted that "the law is now settled that it is reasonable to extrapolate the results of a one-day observation test over a multiple-year audit period"])). Furthermore, the Division's reliance on the decision of the Tax Appeals Tribunal in *Matter of Burbacki* (February 9, 1995) is well placed. In that case, the Tribunal explicitly approved the use of an observation test conducted during 1986, which was the basis of an earlier assessment on February 3, 1987, to justify the estimate of taxable sales for an assessment issued some five years later which was then under review. Moreover, here, as the Division correctly points out, the observation test was of Spartacus Restaurant and not Aetos Restaurant, albeit on the second day of petitioner's operation by Mr. Kalfas without the help of his ex-wife and children. In addition, no adjustment for rising prices was made in the matter at hand which benefitted petitioner while in *Burbacki*, such adjustment was made. Here and in *Burbacki*, as emphasized by the administrative law judge whose decision in *Matter of Burbacki* (May 19, 1994) was affirmed by the Tribunal, the assessment was not "totally fictitious" and issued "to procure an extension of time for the

[former State Tax] Commission to make a valid determination of additional tax due” as was the case in *Brown v. New York State Tax Commn.* (199 Misc 349, 99 NYS2d 73, *affd* 279 App Div 837, 109 NYS2d 626, *affd* 304 NY 651).

C. The analysis therefore shifts to whether petitioner has shown, despite the conclusion that the audit methodology was reasonable, that “the amount of tax assessed was erroneous” (*Matter of Pay TV of Greater New York, Inc.*, Tax Appeals Tribunal, July 14, 1994 [wherein the Tribunal concluded that the administrative law judge “erred in sustaining the entire assessment”]). The Tribunal in *Pay TV of Greater New York, Inc. (supra)*, observed that “credible testimony that specifically establishes that the amount of tax imposed is incorrect may itself be sufficient to require a reduction to the assessment, without corroborating documentary evidence.” Here, the compelling testimony of Kyriakos Kalfas established that once his life fell apart with his late-in-life divorce and the withdrawal by his former wife and children from the operation of the then family-run restaurant, the business of Spartacus Restaurant plummeted. It is observed that the Division’s auditor forthrightly admitted during his testimony on cross-examination that in his opinion the operations of Aetos Restaurant should not be attributable to Spartacus Restaurant as operated by Mr. Kalfas, which was in a state of decline and would eventually close. Further, the credible testimony of a part-time waitress employed by Mr. Kalfas in the operation of his restaurant bolstered the testimony of Mr. Kalfas and provided support for petitioner’s position that its operation went from five or six employees at the start of the audit period to one or two at the end. Consequently, it is concluded that the amount of taxable sales for the audit period estimated to be \$914,316.03 should be reduced to \$304,772.01, or one-third of the amount estimated based upon the similar percentage decline in the number of employees from six to two over the course of the audit period.

D. Finally, petitioner has not established that its failure to pay tax was due to reasonable cause and not due to willful neglect. In the words of the Tax Appeals Tribunal, in establishing reasonable cause, the taxpayer faces an “onerous task” (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). The Tribunal explained why the task is onerous as follows:

By first requiring the imposition of penalties (rather than merely allowing them at the Commissioner’s discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citations omitted]” (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992).

Furthermore, even with the reduction as noted above, petitioner’s underreporting of taxable sales was in excess of 25% and the omnibus penalty is also properly imposed.

E. The petition of Spartacus of Thraki, Inc. is granted to the extent indicated in Conclusion of Law “C”, and the Notice of Determination dated September 3, 2002 is to be modified to so conform, but, in all other respects, is denied.

DATED: Troy, New York
February 3, 2005

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE